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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 31 and 32

TD 9233

RIN 1545-BC89

Sickness or Accident Disability Payments

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance regarding the treatment of payments made on account of sickness or accident disability under a workers' compensation law for purposes of the Federal Insurance Contributions Act (FICA).

DATES: Effective Date: These regulations are effective December 15, 2005.

Applicability Date: These regulations apply to payments on account of sickness or accident disability payments made on or after December 15, 2005.

FOR FURTHER INFORMATION CONTACT: David Ford (202) 622-6040 (not toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR parts 31 and 32 under section 3121(a)(2) of the Internal Revenue Code (Code). This section excepts from wages for Federal Insurance Contributions Act (FICA) purposes payments

made on account of sickness or accident disability that are received under a “workmen’s compensation law,” hereinafter referred to as a workers’ compensation law.

Proposed regulations (REG-160315-03) under section 3121(a)(2) were published in the **Federal Register** (70 FR 12164) on March 11, 2005. No written comments responding to the notice of proposed rulemaking were received and a public hearing was not requested or held. Accordingly, the proposed regulations are adopted as final regulations. In addition, this document contains amendments to §32.1 of the Temporary Employment Tax Regulations to provide guidance that the definition of workers’ compensation law in the final regulations under §31.3121(a)(2)-1 applies for payments on account of sickness or accident disability made on or after December 15, 2005.

Explanation of Provisions

Section 3121(a)(2)(A) of the Code excepts from “wages” for FICA tax purposes payments to an employee or any of his dependents on account of sickness or accident disability only if the payments are received under a workers’ compensation law.

Section 3121(a)(4) provides that wages does not include any payment on account of sickness or accident disability made by an employer to or on behalf of an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for the employer. Thus, unless made under a workers’ compensation law, payments received on account of sickness

or accident disability are wages subject to FICA during the first 6 months the employee is out of work.

These final regulations amend §31.3121(a)(2)-1 to provide that payments made under a statute in the nature of a workers' compensation act will be treated as having been made under a workers' compensation law and, therefore excluded from wages for FICA purposes. For income tax purposes, section 104(a)(1) excludes from gross income certain amounts received under "workmen's compensation acts." Section 1.104-1(b) of the Income Tax Regulations, provides that amounts received under section 104(a)(1) include amounts received by an employee under a statute in the nature of a workers' compensation act. Thus, the final regulations align the interpretation of what constitutes payments received under a workers' compensation law for FICA purposes with §1.104-1(b) of the Income tax regulations.

The preamble to the proposed regulations specified that §32.1 of the Temporary Employment Tax Regulations would be amended, if needed. It is necessary to remove the reference to §31.3121(a)(2)-1(a)(2) in the first phrase of §32.1(a) and insert a reference to §31.3121(a)(2)-1(d)(3) in §32.1(a)(1) to specify that the definition of workers' compensation law applicable to payments on account of sickness or accident disability made on or after December 15, 2005, is now in final regulation §31.3121(a)(2)-1(d)(3). No other amendments are made to §32.1.

The preamble to the proposed regulations also specified guidance would be provided related to Federal Unemployment Tax Act (FUTA) to the extent

necessary. The IRS has concluded that no additional guidance is necessary for FUTA since these payments are made to employees of states and local governments and FUTA does not apply to services performed by state or local government employees.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. In addition, because no collection of information is imposed on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small business.

Drafting Information

The principal author of these regulations is David Ford of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt/Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 31

Employment taxes, Fishing vessels, Gambling, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

26 CFR Part 32

Employment taxes, Railroad retirement, Reporting and recordkeeping requirements, Social security.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 31 and 32 are amended as follows:

PART 31 -- EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

Paragraph 1. The authority section for part 31 continues to read, in part, as follows:

Authority 26 U.S.C. 7805 * * *

Par. 2. Section 31.3121(a)(2)-1 is amended by:

1. Revising the section heading.
2. Removing paragraph (a)(1).
3. Redesignating paragraphs (a)(2) through (a)(4) as (a)(1) through (a)(3), respectively.
4. Revising newly redesignated paragraph (a)(1).
5. Redesignating paragraph (d) as (f).
6. Adding new paragraphs (d) and (e).

The revisions and additions are as follows:

§31.3121(a)(2)-1 Payments on account of sickness or accident disability, medical or hospitalization expenses, or death.

(a) * * *

(1) Sickness or accident disability of an employee or any of his dependents, only if payment is received under a workers' compensation law;

* * * * *

(d) Workers' compensation law. (1) For purposes of paragraph (a)(1) of this section, a payment made under a workers' compensation law includes a payment made pursuant to a statute in the nature of a workers' compensation act.

(2) For purposes of paragraph (a)(1) of this section, a payment made under a workers' compensation law does not include a payment made pursuant to a State temporary disability insurance law.

(3) If an employee receives a payment on account of sickness or accident disability that is not made under a workers' compensation law or a statute in the nature of a workers' compensation act, the payment is not excluded from wages as defined by section 3121(a)(2)(A) even if the payment must be repaid if the employee receives a workers' compensation award or an award under a statute in the nature of a workers' compensation act with respect to the same period of absence from work.

(4) If an employee receives a payment on account of non-occupational injury sickness or accident disability such payment is not excluded from wages, as defined by section 3121(a)(2)(A).

(e) Examples. The following examples illustrate the principles of paragraph (d) of this section:

Example 1. A local government employee is injured while performing work-related activities. The employee is not covered by the State workers' compensation law, but is covered by a local government ordinance that requires the local government to pay the employee's full salary when the employee is out of work as a result of an injury incurred while performing services for the local government. The ordinance does not limit or otherwise affect the local government's liability to the employee for the work-related injury. The local ordinance is not a workers' compensation law, but it is in the nature of a workers' compensation act. Therefore, the salary the employee receives while out of work as a result of the work-related injury is excluded from wages under section 3121(a)(2)(A).

Example 2. The facts are the same as in Example 1 except that the local ordinance requires the employer to continue to pay the employee's full salary while the employee is unable to work due to an injury whether or not the injury is work-related. Thus, the local ordinance does not limit benefits to instances of work-related disability. A benefit paid under an ordinance that does not limit benefits to instances of work-related injuries is not a statute in the nature of a workers' compensation act. Therefore, the salary the injured employee receives from the employer while out of work is wages subject to FICA even though the employee's injury is work-related.

Example 3. The facts are the same as in Example 1 except that the local ordinance includes a rebuttable presumption that certain injuries, including any heart attack incurred by a firefighter or other law enforcement personnel is work-related. The presumption in the ordinance does not eliminate the requirement that the injury be work-related in order to entitle the injured worker to full salary. Therefore, the ordinance is a statute in the nature of a workers' compensation act, and the salary the injured employee receives pursuant to the ordinance is excluded from wages under section 3121(a)(2)(A).

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PART 32 -- TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE ACT OF DECEMBER 29, 1981 (PUB. L. 97-123)

Par. 3. The authority section for part 32 continues to read, in part, as follows:

Authority 26 U.S.C. 7805 * * *

Par. 4. Section 32.1 is amended by:

1. Revising paragraph (a) introductory text.
2. Revising paragraph (a)(1).

The revisions and additions are as follows:

* * * * *

(a) General rule. The amount of any payment on or after January 1, 1982, made to, or on behalf of, an employee or any of his dependents on account of sickness or accident disability is not excluded from the term wages as defined in section 3121(a)(2)(A) unless such payment is--

(1) Received under a workmen's compensation law (as defined in §31.3121(a)(2)-1(d)(3) of this chapter for payments made on or after December 15, 2005), or

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Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved: December 1, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury (Tax Policy).